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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF
LITCHFIELD PARK SERVICE COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE FAIR VALUE OF
ITS UTILITY PLANTS AND PROPERTY AND
FOR INCREASES IN ITS WATER AND
WASTEWATER RATES AND CHARGES FOR
UTILITY SERVICE BASED THEREON.

DOCKET NO. SW-01428A-09-0103

IN THE MATTER OF THE APPLICATION OF
LITCHFIELD PARK SERVICE COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE FAIR VALUE OF
ITS UTILITY PLANTS AND PROPERTY AND
FOR INCREASES IN ITS WATER RATES
AND CHARGES FOR UTILITY SERVICE
BASED THEREON.

DOCKET NO. W-01427A-09-0104

IN THE MATTER OF THE APPLICATION OF
LITCHFIELD PARK SERVICE COMPANY,
AN ARIZONA CORPORATION, FOR
AUTHORITY (1) TO ISSUE EVIDENCE OF
INDEBTEDNESS IN AN AMOUNT NOT TO
EXCEED \$1,755,000 IN CONNECTION WITH
(A) THE CONSTRUCTION OF TWO
RECHARGE WELL INFRASTRUCTURE
IMPROVEMENTS AND (2) TO ENCUMBER
ITS REAL PROPERTY AND PLANT AS
SECURITY FOR SUCH INDEBTEDNESS.

DOCKET NO. W-01427A-09-0116

Arizona Corporation Commission

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FEB 24 2010

DOCKETED BY	<i>[Signature]</i>
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1 IN THE MATTER OF THE APPLICATION OF
2 LITCHFIELD PARK SERVICE COMPANY,
3 AN ARIZONA CORPORATION, FOR
4 AUTHORITY (1) TO ISSUE EVIDENCE OF
5 INDEBTEDNESS IN AN AMOUNT NOT TO
6 EXCEED \$1,170,000 IN CONNECTION WITH
7 (A) THE CONSTRUCTION OF ONE 200 KW
8 ROOF MOUNTED SOLAR GENERATOR
9 INFRASTRUCTURE IMPROVEMENTS AND
10 (2) TO ENCUMBER ITS REAL PROPERTY
11 AND PLANT AS SECURITY FOR SUCH
12 INDEBTEDNESS.

DOCKET NO. W-01427A-09-0120

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14 **CLOSING POST-HEARING BRIEF**
15 **OF CITY OF LITCHFIELD PARK**
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1 **I. The Legal Framework for Ratemaking in Arizona and the Record Support**
2 **Placing a 7.5 % Cap on the Company's Return**

3 Litchfield Park Service Company (the "Company" or "LPSCO") discusses the
4 legal framework for ratemaking in Arizona. What the Company totally ignores is that under
5 Arizona law it is the Commission, not the witnesses, that determines the ultimate issues –
6 what constitutes a fair and reasonable return and what are fair and just rates. While the
7 Commission's decision must be founded upon the record evidence, it is not bound by the
8 limits of the recommendations advanced by the witnesses.¹ The Commission may adopt or
9 blend the recommendations of the witnesses, or reject them all in favor of its own
10 interpretation of the evidence presented. "The founders expected the Commission to provide
11 both effective regulation of public service corporations and consumer protection against
12 overreaching by those corporations."²

13 In its Opening Post Hearing Brief, the City of Litchfield Park (the "City")
14 explained that, based upon the record, the Commission must cap the Company's return at
15 7.5% based upon the combination of: 1) the magnitude of the rate relief being requested
16 (which is similar in magnitude to rate increases requested by other AWRA owned Arizona
17 utilities), 2) the Company's decision to delay filing for rate relief for eight (8) years, thereby
18 pancaking the inclusion of the significant cost of several new plant additions with the seven
19 (7) million dollars in repairs, upgrades and/or modifications at the Palm Valley Wastewater
20 Reclamation Facility ("PVWRF"),³ 3) the Company's decision to forego seeking any

21 _____
22 ¹ *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 153, 294 P.2d 378, 383 (1956) (the Commission is
23 entitled to reasonably determine the probative force of these estimates).

24 ² *Arizona Corp. Com'n v. Woods*, 171 Ariz. 286, 290, 830 P.2d 807, 811 (1992) (discussing the genesis of the
25 Commission). This citation is not intended to suggest that the Company has overreached, but demonstrates the
fundamental function of the Commission is to balance the needs of the public and public service corporations,
with an emphasis on protecting the consumer.

³ Unlike RUCO, the City does not question the original design of the plant or the Company's actions in
addressing the odor and operational issues at the PVWRF. The issue here is to what degree the need for these

1 additional debt financing since being acquired by AWRA resulting in an equity rich capital
2 structure in excess of 80%, 4) RUCO's and Staff's recognition that their estimates of the cost
3 of common equity do not fully adjust for the equity rich capital structure, 5) the Company's
4 decision to develop an extremely complex management and operational structure that
5 interlaces affiliate upon affiliate making regulatory oversight and review more difficult and its
6 failure to fully substantiate the reasonableness of its allocation methodology down to LPSCO,
7 6) the Company's decision to classify expenditures such as contributions and sporting event
8 tickets as "licenses and fees" and initially seeking to recover them as prudent expenditures, 7)
9 the Company's failure to allocate even \$1.00 of the costs of its holding company to the
10 holding company Algonquin Power Trust, including costs of stockholder communications and
11 compliance costs associate with being listed on the Toronto Stock Exchange, 8) the
12 Company's lack of a written policy regarding capitalizing versus expensing expenditures on
13 plant, 9) the dire economic condition facing the State of Arizona and 10) the general need to
14 consider the customers interests in setting rates that will provide the shareholders a reasonable
15 return on their investment in property devoted to serving the public.

16 The Company's suggestion that it would be 'unlawful' for the Commission "to
17 reduce an otherwise prudent operating expense because economic conditions might make it
18 more difficult for some customers to pay the cost of service"⁴ misses the point. The
19 Commission has the *exclusive* and *plenary* power to determine what constitutes a reasonable
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22 actions so quickly after the initial plant was installed, coupled with the other factors listed herein, warrant the
23 Commission authorizing a return below the weighted average cost of capital (the sole measure used by RUCO,
24 Staff and the Company to establish the rate of return) in this rate proceeding. Rather than permanently
25 removing a portion of the value of the plant modifications from rate base as suggested by RUCO, the City's
recommendation reaches a reasonable balance between the needs of the Company and ratepayers - minimizing
the adverse impacts of the adverse pancaking impacts of seeking inclusion of the base plant and the
modifications in a single rate case by lowering the return allowed for the period these rates are in place.

⁴ LPSCO Initial Closing Brief at p. 10:15-17.

1 return and to set fair and reasonable rates.⁵ In fact when first confronted with construing the
2 Commission's powers, the Arizona Supreme Court recognized that the Commission was
3 clothed "with full power to investigate, hear, and determine disputes and controversies
4 between public utility companies and the general public . . . primarily for the interest of the
5 consumer."⁶ Thus, the Company's contention that the "Commission has no authority to
6 impose an additional 'discount' that is not supported by the testimony, based on assumed
7 difficulties experienced by individual consumers"⁷ is without merit, to the extent the
8 Company is suggesting the Commission is without authority to draw its own inferences and
9 conclusions from the record, and is limited to the specific "discounts" or returns offered by
10 the witnesses.

11 LPSCO also contends that *Arizona Community Action* "does not stand for the
12 proposition that the Commission may lower rates below the cost of service because current
13 economic conditions are unfavorable."⁸ While the case did not expressly deal with the impact
14 of economic conditions on the Commission's authority to set rates, it does unequivocally
15 state:

16 In determining what is a reasonable price to be charged for services
17 by a public-service corporation, an examination must be made not
18 only from the point of view of the corporation, but from that of the
19 one served, also. A reasonable rate is not one ascertained solely from
20 considering the bearing of the facts upon the profits of the
21 corporation. The effect of the rate upon persons to whom services are
22 rendered is as deep a concern in the fixing thereof as is the effect
upon the stockholders or bondholders. A reasonable rate is one which

23 ⁵ Ariz. Const. Art. 15, Sec. 3; *State v. Tucson Gas, Elec. Light & Power Co.*, 15 Ariz. 294, 301, 138 P. 781, 784
24 (1914).

25 ⁶ *Id.* 15 Ariz. at 308, 138 P. at 786 (*emphasis added*).

⁷ *Id.* at p. 11: 4-6.

⁸ LPSCO Initial Closing Brief at p. 11:12-14.

1 is as fair as possible to all whose interests are involved. (Emphasis
2 added.)⁹

3 The Court was quoting our territorial Supreme Court in *Salt River Valley Canal Co. v.*
4 *Nelssen*, 10 Ariz. 9, 13, 85 P. 117, 119 (1906). In that case, the Court upheld the court's
5 authority to invalidate rates that were unfair to the ratepayer relying on the following
6 pronouncement of the United States Supreme Court in *Covington & L. Turnpike Road Co. v.*
7 *Sandford*, 164 U.S. 578, 596, 17 S. Ct. 198, 205 (1896):

8 It cannot be said that a corporation is entitled, as of right, and without
9 reference to the interests of the public, to realize a given per cent
10 upon its capital stock. When the question arises whether the
11 Legislature has exceeded its constitutional power in prescribing rates
12 to be charged by a corporation controlling a public highway,
13 stockholders are not the only persons whose rights or interests are to
14 be considered. The rights of the public are not to be ignored. * * *
15 The public cannot properly be subjected to unreasonable rates in
16 order simply that stockholders may earn dividends. * * * If a
17 corporation cannot maintain such a highway and earn dividends for
18 stockholders, it is a misfortune for it and them which the Constitution
19 does not require to be remedied by imposing unjust burdens upon the
20 public. [* * *] In using the expression 'value of the service rendered'
21 we must understand that the word 'value' means value to the person
22 to whom the service is rendered.

23 Thus, the courts have long recognized that a ratepayers' right to be free of rates
24 that pose unjust burdens on the public outweigh the right of a utility to provide dividends to
25 its stockholders. Certainly the *Arizona Community Action* Court, in recognizing the utility
has the right to assure its investors a reasonable return, did not hold, or even infer, that such
assurance could impose unjust burdens upon the public or rates that otherwise fail to reflect
an appropriate balancing of the interests of shareholders and ratepayers. The City believes

⁹ 123 Ariz. at 231, 599 P.2d at 187.

1 that, based upon the record of this case, any return on the fair value rate base beyond 7.5%
2 would not be fair to “to all whose interests are involved” including the ratepayers.

3 **II. THE RATE DESIGN PROPOSED BY THE COMPANY AND THE CITY**
4 **IS FAIR AND REASONABLE**

5 **A. The Effluent Rate**

6 RUCO does not address rate design issues, other than the effluent rate.¹⁰ The
7 City shares the Company’s concern that a sudden shift from a low rate of \$0.17 per thousand
8 to a flat rate of \$1.50 per thousand may have adverse unintended consequences. At the same
9 time, the City agrees with RUCO the current “market rate” is an undefined rate that allows the
10 Company to charge whatever rate for effluent it negotiates with a particular customer.

11 While Staff does not address the issue in its Opening Brief, its Final Schedules
12 proposed a definition of “Market Rate” as between a maximum of \$430 per acre foot (or
13 \$1.32 per 1000 gallons) and a minimum of not less than \$0.87 per thousand (computing to
14 \$282.75 per acre foot).¹¹ The City also advocated setting a range within which the Market
15 Rate must fall in order to protect consumers against unreasonably high or low effluent rates.
16 Upon considering the arguments presented in the Opening Brief, the City now believes it
17 appropriate to set the maximum effluent rate equivalent to mid-tier of the potable water rate
18 (e.g., \$1.88 based upon Staff’s Final Schedules). The City further believes the minimum rate
19 of \$0.87 proposed by Staff is reasonable for new customers. However, to avoid unintended
20 adverse consequences raised by the Company and to apply the concepts of gradualism to
21 effluent customers, the City now recommends rates for existing effluent customers rates be
22 increased in phases until the minimums proposed by Staff are reached. The City recommends
23 the first increase be limited 100% (a doubling of the rate), with annual 25% increases

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25 ¹⁰ RUCO Initial Closing Brief at 23-24.

¹¹ Staff Final Schedules, Exhibit 1, PMC-1WW, page 1 of 2.

1 thereafter until the minimum is reached (or alternative rates are set in a subsequent rate case).
2 This would double the \$0.17 per thousand rate to \$0.34 initially and bring these customers to
3 the Staff's recommended minimums no later than the sixth year after rates are effective in this
4 case.

5 B. Water Rates

6 The Company's Initial Closing Brief provides an excellent discussion of the
7 advantages of the rate design jointly proposed by the Company and the City.¹² As the
8 Company notes, the primary goal of both RUCO's and Staff's rate designs "is to ameliorate
9 the impacts of rate increases on residential customers."¹³ This shifting is inappropriate when
10 it contravenes the cost of providing service as it sends an improper price signal relating to the
11 cost of service. This goal is also better served by the low income rate being proposed by the
12 Company, not by a general subsidy for the entire customer class.

13 The rate designs of Staff and RUCO compensate for subsidizing the cost of
14 service of the low use residential customers by shifting the cost obligation to non-residential
15 customers and to residential customers that use larger quantities of water. While some
16 shifting of costs to these customers may be consistent with the goal of promoting water
17 conservation, it should not be used to penalize customers that are using water to maintain an
18 environment that LPSCO was created to serve. The City hopes the Commission will move
19 cautiously in proposing rates that encourage the City and its residents to abandon the
20 communal environment that has existed since the establishment of the City and is a
21 fundamental aspect of the quality of life of the Community.

22 RUCO does not discuss rate design in its Initial Opening Brief.

23
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25 ¹² LPSCO Initial Closing Brief at 80-82.

¹³ *Id.* at 82:15-16.

1 Staff contends its rate design is “typically a three-tier design with break over
2 points and monthly minimum charges set at levels designed to encourage the efficient use of
3 water.”¹⁴ However, as reflected above, a primary focal point of the Staff’s rate design is to
4 shift cost responsibility from residential customers, especially those using small quantities of
5 water. A problem with this approach is that it under prices the base cost of providing the
6 service. “Even though many factors influence rate design, the cost based approach has a
7 significant, if not dominant, role.”¹⁵ “That all rates should be based on ‘costs’ is almost a
8 truism.”¹⁶ The joint rate proposal of the Company and the City is the only proposal that truly
9 attempts to move the rates to recover costs more equally among classes and users.

10 “[T]he first requirement for a rate designer is to gain a thorough understanding
11 of the utility’s service area.

12 (1) What is the nature of the service area?

13 (2) Is the service area largely residential and commercial, or is there a
14 preponderance of industry?

15 (3) What are the demographic trends in the area?

16 (4) What are the social-economic factors significant to the area and its future?

17 (5) What are the competitive factors involved inn the utility’s service area?

18 (6) What, if any are the problems associated with the present rates. . .

19 (7) Does the public understand and accept the present rates?”¹⁷

20 The joint rate proposal of the Company and the City is the only proposal that
21 truly attempts to take the character of LPSCO’s service area into consideration.

22
23 ¹⁴ Staff Opening Brief at 23.

24 ¹⁵ Robert L. Hahen and Gregory E. Aliff, Accounting for Public Utilities §10.05 (Matthew Binder).

25 ¹⁶ *Id.* at 10-20.

¹⁷ *Id.* at 10-18.

1 As summarized by the Company "the rate design proposed by the City and
2 LPSCO is consistent with the Commission's goal of encouraging water conservation, while
3 adhering to cost of service principles and moving customers on smaller meters closer to the
4 cost of service."¹⁸

5 C. Phasing

6 Staff did not propose the phasing-in of any rate increase authorized in this
7 proceeding either in its Opening Brief or in its final schedules. RUCO does not address
8 phasing in its Initial Closing Brief, but does make a phasing proposal in its final schedules
9 which the Company adopts, with one exception. The Company opposes the discontinuance of
10 the carrying cost after the first six (6) months.

11 The City proposed a similar phase-in, except that the City's proposal does not
12 delay implementing the second and third phases a full six (6) months each. The reason for
13 this is that the new rates will likely go into effect at the beginning of this summer. Under
14 RUCO's and the Company's proposals both the first and third phases would be implemented
15 during the heaviest use months, thereby intensifying the negative impact of these phases.
16 Therefore, the City had proposed phasing to avoid having the final phase going into effect
17 during the beginning of next summer. The City's proposal would also minimize the carrying
18 costs related to the phase-in. The City, however, can also support the timing and size of the
19 phases now apparently acceptable to both the Company and RUCO.

20 III. RATE CASE COSTS

21 The City did not actively oppose or support the rate case costs the Company
22 originally requested to recover in this matter.¹⁹ The City supports the five (5) year
23

24 ¹⁸ LPSCO Initial Opening Brief at 82.

25 ¹⁹ In view of the growth of the holding company form of operation for water and sewer companies in Arizona representing an ever larger percentage of the consumers receiving regulated service, the City encourages the Commission to look at methods of simplifying and reducing the cost of examining the rates for the individual

1 amortization period recommended by RUCO and Staff rather than the three (3) year period
2 advocated by the Company. The City, however, does actively oppose the additional \$80,000,
3 or \$40,000 per division requested by the Company. While AWRA is free to decide when and
4 how to process rate applications, its decision to wait eight years to pursue a rate case for
5 LPSCO and its complex organizational structure are major contributing factors that drive its
6 rate case costs. The \$420,000 estimate originally presented and accepted by Staff and RUCO
7 stretches the reasonableness of such costs to its limit. The Company's latest request to add
8 yet another \$80,000 to this cost should be summarily rejected.

9 IV. CONCLUSION

10 A cap of a 7.5% return on fair value rate base, as recommended by the City, still
11 results in a significant increase in revenue for the Company. Based upon Staff recommended
12 adjustments and LPSCO's gross revenue conversion factor, the City calculates the revenue
13 increase to be \$4,127,650 for the water division (a 60% increase) and \$2,545,902 for the
14 sewer division (a 40% increase). This level of increase will provide the Company an
15 opportunity to earn a 7.73% return on the heavy amount of common equity invested in
16 LPSCO. While this is below the return on common equity recommended by Staff, RUCO
17 and the Company, it reflects a reasonable balancing of the impacts of the items identified on
18 this record, and listed above, while still providing a return 247 basis points above lowest
19 current cost of equity (5.25%) established by the evidence.

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22 systems under common ownership. For example the Commission could mandate a set schedule of filing of rate
23 applications for the various systems of the larger holding companies – this also ensures that the allocation
24 methodologies and business practices of the parent are constantly reviewed by the Commission. The filing may
25 or may not necessitate a full hearing. The Commission could also use a single capital structure based on the
parent or the cumulative capital structure of the Arizona utilities and attempt to minimize cost of equity issues
by filing periodic bench mark rates that utilities could elect to use. Such efforts would minimize the likelihood
of large increases as faced in this case, while spreading the work load for Staff, the Company and intervenors,
including RUCO.

1 A cap of a 7.5% return, coupled with the rate design supported by the Company
2 and the City and a reasonable phase-in of the rate increase, constitute the only
3 recommendations that reflects an appropriate balancing of the interests of the Company and
4 the ratepayers based upon *all* the evidence presented on this record. All other
5 recommendations are based solely on the application of a rigid formula of multiplying the fair
6 value rate base by the weighted average cost of capital times the fair value rate base to
7 calculate the level of revenues to authorize. While this formulistic approach often is
8 appropriate, in the unique circumstances of this case it places an "unjust burden on the
9 public" – a burden the United Supreme Court found inappropriate²⁰ and a burden the *Arizona*
10 *Community Action* and *Tucson Gas* cases require this Commission to consider in setting a
11 reasonable return and fair and reasonable rates.

12 DATED this 24th day of February, 2010.

13 CURTIS, GOODWIN, SULLIVAN,
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23
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²⁰ *Covington & L. Turnpike Road Co. v. Sandford*, 164 U.S. 578, 596, 17 Sup. Ct. 198, 205 (1896).